

Postern Newsletter 2011

WHEN IS THE BEST TIME TO TAKE ACTION?

Our experience from regular discussions with lenders has shown that over the past few years there has been a relatively passive approach by lenders towards their customers. Provided interest is paid on customer loans, no definitive action is taken, despite warnings that may be flagged in internal dashboards and irregular or insufficient financial reporting by those companies.

In the SME sector, margins continue to erode, profitability and values decrease, and there is a general inability by companies to pay down their borrowings. In spite of that, lenders are inclined not to interfere, allowing these companies to trade on unchallenged, as if everything were in order. No recommendations are being made to existing management within these companies that they would do well to garner operational support and help from experienced operatives. In fact many companies are trading water, even submerging; some are even technically bust, but they continue to operate because of an environment created by low interest rates and general inertia. Lenders have had their own distraction in bolstering their balance sheets, and would rather turn a blind eye to possible issues with their customers, hoping that 'a miracle cure will resolve the companies' woes'. This in turn just means that customers maintain a blinkered approach to the situation and just keep going – don't ask, don't tell.

After the Lehman Brothers' collapse in September 2008 and the ensuing severe economic downturn in 2009, lenders' expectations were that eventually the economy would improve and accordingly many customers' loan banking covenants were re-set by their lenders.

Clearly the economy has not improved and now the expectations are that it will take much more time. The general unease in the Eurozone is adding to the

fear of a protracted period of uncertainty. However, these 'extend and pretend' bank policies have effectively maintained a growing army of 'corporate zombies', many of which are now doomed to failure, unless swift corrective action is taken to improve efficiency of operations, and cash generation within those businesses.

What can change this deadly dynamic? Certainly any increase in interest rates would create movement - albeit perhaps a negative one. But this might NOT be enough to instigate action from lenders and customers in the recognition that urgent corrective action is necessary. In many cases, company management need help, but are afraid to ask for it. They can be overwhelmed by the challenges they face and simultaneously deceived by the climate of inertia.

Outside intervention can help, provided it is done early enough in the process. However, if the downward spiral is allowed to continue for too long it will be too late. It can trigger insolvency or a restructuring of debt that can lead to severe value destruction in that business. If a company seeks help from experienced operational turnaround and restructuring specialists in a timely manner, an orderly approach can be taken to maximise value and save the company.

At Postern we have a consistent track record of de-risking banks and improving the enterprise value of businesses. We are used to dealing with critical situations, identifying the value destroyers and optimizing the value enhancers for stakeholders and creditors prior to any possible IP involvement. Postern is able to bring a wealth of experience to the table. The most important step is to take action before it's too late.

Highlights this Issue

- [Taking Early Action](#)
- [Corporate Governance](#)
- [Zombie Environment](#)

"A governance framework is not only relevant for financial institutions and listed companies; corporate governance is essential in underpinning entrepreneurship in all kinds of enterprise. Listed companies should not be the only ones benefiting from good corporate governance standards"

- Dr. Roger Barker, IoD's Head of Corporate Governance



The Distress of the Euro-zone

RESPONDING TO THE FIRST SIGNS OF DISTRESS

Postern cannot emphasize enough the absolute necessity of engaging operational support at the earliest possible opportunity.

In a recent case for Private Equity for a Civil Engineering and Contracting Company – PE's regular dashboards - which are a helpful approach in monitoring a business - 'amber flagged' problems three months prior to Postern's engagement in the company. This was subsequently acknowledged by the Company's Commercial Director - when it was identified and recorded in the PE's dashboard that there was a crisis in the short term cash requirement of the business.

There is much that could have been done in taking corrective action earlier to maximize benefits all round and avert a reactionary insolvency process which subsequently ensued.

In the case of the Company in question, there were potentially viable aspects of the business going forward - intrinsic strengths in know-how and market position; but it was clearly hampered by:

- Poor price build-up and weak approach to maximizing margins;
- The corporate structure was unviable - excessive cost base, dysfunctional management and accumulated creditor pressure;

But, value from the business could have been optimized by:

- Developing a business plan incorporating only the viable elements;
- Using the business plan to support assets and goodwill sales to third parties or management;
- Supporting the management in the disposal process and interim operations of the business;

Postern's engagement at an earlier stage in effectively a CRO capacity would have been helped by PE making clear to existing management that

they needed to effectively 'buy-in' to the process, also clarifying Postern's role and reinforcing it as independent restructuring advisors – there to help maximise creditor positions. Moreover, it would remove any concerns that PE were taking an active role in management decisions. Administrators or other insolvency processes would be confined to dealing with those parts of the business which were unsustainable but would leave the viable parts out of any insolvency so preserving maximum value.

The overall point is that where companies are financially distressed, value can generally best be optimised through the orderly disposals of assets and goodwill either to a third party or management. Particular points to note in this regard are:

- Insolvency processes are in last resort and only applied to those parts of the business that are not viable;
- The benefits flow to creditors (enhanced returns), suppliers and customers (continued operations) and staff (some retention of employment and skills) are significantly improved;
- The role of Insolvency Practitioners is changed from being a key driver of the process, to a support role administering any appropriate insolvency process. This overcomes the issue of their direct appointment in itself which often destroys value, but is a problem for IPs as it reduces their commercial returns.

Michael Scordino
Chief Executive
Postern
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Low interest rates have kept the economy in a low growth environment where distress fails to surface, but companies cannot grow.

Postern

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We Implement
We Deliver**

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